

# Joint Economic Committee WEEKLY ECONOMIC DIGEST

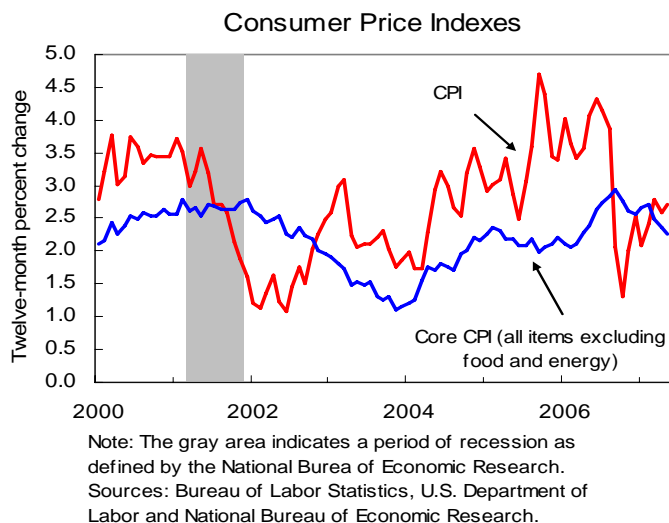
Senator Charles Schumer, Chairman  
Congresswoman Carolyn Maloney, Vice Chair

June 18, 2007

## ECONOMIC NEWS

### Though Sales Surged, Core Inflation Edged Down

**Rising energy prices continued to boost overall inflation, but core inflation declined in May.** The consumer price index (CPI) increased by 0.7 percent last month, following a 0.4 percent rise in April. Energy prices accelerated, rising by 5.4 percent in May, after increasing by 2.4 percent in April. However, the core CPI (which excludes the volatile prices of food and energy) increased by 0.1 percent last month after rising 0.2 percent in April. Over the past 12 months, the CPI has risen by 2.7 percent, and the core CPI by 2.2 percent (see chart).



**Retail sales rebounded sharply in May.** Sales at retail establishments and food services increased by 1.4 percent last month, after slipping by 0.1 percent in April. Sales of motor vehicles and parts rose by 1.3 percent last month, and a 10.6 percent climb in gasoline prices contributed to a 3.8 percent rise in sales at gas stations. Excluding motor vehicles and gasoline, retail sales rose by 1.0 percent in May, reaching a level that is 4.7 percent higher than a year earlier.

**Industrial production stalled in May.** Industrial production in manufacturing, mining, and utilities was unchanged last month, following a 0.4 percent rise in April. Utility output, which has been volatile in recent months due to unusually sharp weather fluctuations, declined 1.3 percent last month, after rising 3.4 percent in April. Manufacturing output barely grew in May, rising by 0.1 percent. That is only 1.9 percent above last year's level and well below the average 12-month pace of recent years.

## IN FOCUS

### The Unsustainable Current Account Deficit

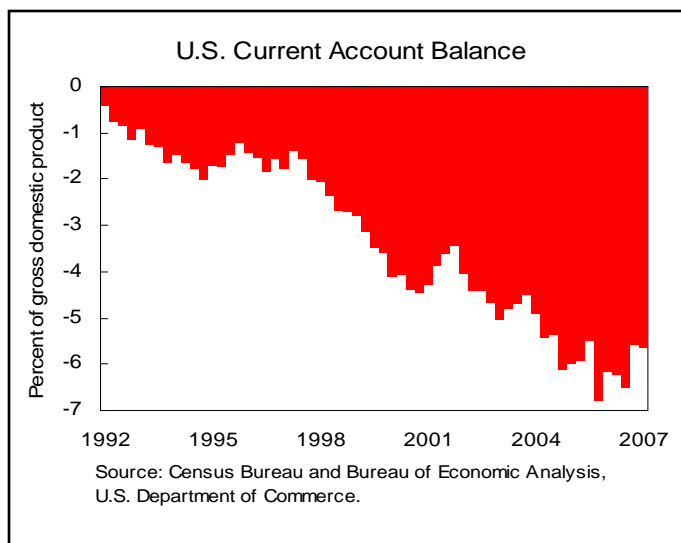
Last week, the Department of Commerce reported that the U.S. current account deficit—which combines the balance on trade in goods and services with the balance on international income flows and transfers—grew by \$4.7 billion to \$192.6 billion in the first quarter of 2007. At 5.7 percent of gross domestic product (GDP), the current account deficit remains near its historically high levels in recent years (see Snapshot). That level is unsustainable.

The current account deficit measures the excess of a country's spending over its income. Equivalently, the current account deficit measures the shortfall between the nation's saving and its investment. When the total amount saved by U.S. consumers, businesses, and governments falls short of national investment, that level of investment can be maintained through foreign borrowing. The current account deficit is unsustainable because the United States cannot continue accumulating foreign debt faster than it can repay it.

Last year, net domestic investment (investment spending in excess of the amount required to maintain the existing capital stock) was 8.1 percent of GDP. However, net national saving (total saving less depreciation of the capital stock) was only 2.0 percent. That shortfall between investment and saving is reflected in the current account deficit which amounted to 6.1 percent of GDP in 2006.

*Continued on reverse...*

## SNAPSHOT



# Joint Economic Committee WEEKLY ECONOMIC DIGEST

## THE WEEK AHEAD

DAY	RELEASE
Tuesday 19	New Residential Construction (May 2007) State Employment and Unemployment (May 2007)
Thursday 21	U.S. Leading Indicators (May 2007) Weekly Report on Unemployment Insurance Claims (Week ending June 16)
Friday 22	Monthly Labor Department Report on Mass Layoffs (May 2007)

*Tuesday,  
June 19th:  
Data on new  
homebuilding  
in May*

## THE ECONOMY AT A GLANCE

KEY INDICATORS	MONTH			QUARTER			YEAR	
	May	Apr	Mar	2007 Q1	2006 Q4	2006 Q3	2006	2005
Real GDP Growth (%)	—	—	—	0.6	2.5	2.0	3.3	3.2
Unemployment (% of labor force)	4.5	4.5	4.4	4.5	4.5	4.7	4.6	5.1
Labor Productivity Growth (%)	—	—	—	1.0	2.1	-0.5	1.6	2.1
Labor Compensation Growth (%)	—	—	—	3.2	3.6	3.6	3.1	3.3
CPI-U Inflation (%)	8.7	4.9	7.4	3.8	-2.1	3.1	3.2	3.4
Core CPI-U Inflation (%)	1.2	2.4	1.2	2.3	1.9	3.0	2.5	2.2

Sources: Bureau of Economic Analysis, U.S. Department of Commerce; Bureau of Labor Statistics, Department of Labor.

Notes: Except where otherwise noted, values in the table represent percent changes at seasonally adjusted annual rates. Productivity is output per hour worked in private nonfarm businesses. The Employment Cost Index is for civilian workers in government and business. Core CPI-U inflation is the percent change in the CPI-U excluding food and energy as reported by the Bureau of Labor Statistics. The designation "n.a." denotes that data are not yet available.

## IN FOCUS (Continued)

The shortfall of domestic saving has increased since 2000. While the rate of net domestic investment has fallen by 0.6 percentage point of GDP over the past six years, the rate of net national saving has fallen by even more, dropping 3.9 percentage points of GDP between 2000 and 2006. The single largest factor underlying the decline in national saving in recent years has been the rising federal budget deficit. Because the budget deficit represents spending by the federal government in excess of what it takes in, the deficit directly lowers the national saving rate. In 2000, the federal budget showed a surplus that amounted to 1.9 percent of GDP. In 2006, the federal deficit was 1.1 percent of GDP. Over the intervening six years, rising deficits directly lowered the national saving rate by just over 3 percentage points of GDP.

Continuous shortfalls of national saving imply persistent current account deficits and the resolution of the current account imbalances will require a depreciation of the U.S. dollar relative to other currencies. In recent years, the United States has been able to finance a rate of domestic investment that exceeds its national saving rate largely because foreign investors (individuals, businesses, and governments) have been willing to hold dollar-denominated assets. That cannot continue forever. Absent changes in U.S. policy, the growing abundance of dollar-denominated assets will eventually work to depreciate the dollar even further than has already occurred in recent years. Persistent U.S. current account deficits work to lower foreigners' expected rate of return on dollar-denominated assets and, other things equal, that will discourage foreign investors from further financing U.S. investment. While the result of a declining dollar would eventually be a smaller trade deficit, the speed and extent of such a turnaround could dramatically affect U.S. economic growth.

While most economists expect the adjustment to be gradual, an abrupt adjustment represents a risk to the outlook for U.S. economic growth. In any event, however, the single most potent option for U.S. policymakers to help mitigate the coming current account adjustment is a significant and sustained reduction in the federal deficit.